No. 10,932

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA,

Appellant,

vs.

PAUL W. SAMPSELL, Trustee in Bankruptcy of the Estate of El Camino Refining Company, STATE OF CALIFORNIA and UNIVERSAL CONSOLIDATED OIL COMPANY,

Appellees.

BRIEF FOR UNIVERSAL CONSOLIDATED OIL COMPANY.

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BRIEF FOR UNIVERSAL CONSOLIDATED OIL COMPANY.

Questions Presented.

Insofar as appellee Universal Consolidated Oil Company, hereinafter throughout this brief referred to as "Oil Company," is concerned, but two questions are here presented and raised by the United States in its brief:

1. Whether the District Court erred in allowing interest to the Universal Consolidated Oil Company on the principal sum due under its mortgage, subsequent to the date of adjudication in bankruptcy, or sale, with the mortgagee's consent, of the mortgaged property free and clear of all liens.

2. Whether the District Court erred in subordinating the tax liens of the United States to the payment of attorney's fees and interest on the principal sum due under the mortgage to the Universal Consolidated Oil Company subsequent to the date of adjudication in bankruptcy.

Statutes Involved.

Bankruptcy Act of 1898, c. 541, sec. 67, 30 Stat. 564, as amended by the Act of June 22, 1938, c. 575, sec. 1, 52 Stat. 875, as amended Aug. 22, 1940, c. 686, Title I, sec. 29 (a), 54 Stat. 835, (Title 11, U. S. C. A., sec. 107); Also R. S., sec. 3186, as amended, 26 U. S. C. A., secs. 1560, 1561, 1562.

Statement.

The facts are substantially stated in appellant's brief.

Summary of Argument.

The points raised on appeal by the government in its brief, and considered here, were not raised in the court below; and it is submitted that the government should properly be precluded from raising these questions for the first time upon appeal.

The government concedes the priority of appellee oil company's lien, and also concedes in effect that the composition of the lien as it exists under the law of California will be recognized as a valid lien in bankruptcy; that the general rule that interest stops running upon both secured and unsecured claims after a debtor has passed into bankruptcy is limited by the exception in favor of the secured creditor whose security is sufficient to pay his claim for interest as well as principal.

But the government contends that the exception is itself circumscribed by a purported rule that where property is subject to two liens interest will not run on the superior to the detriment of the principal of the second. However, this last rule, contended for by the government, finds no support in the authorities cited.

The government also contends that the appellee oil company, as mortgagee, is not entitled to subordinate the tax lien of the United States to a greater sum than existed on the date the government lien attached because at that moment the property had in a sense two owners, the mortgagee to the extent of its debt and the United States to the extent of its lien. This theory finds no support in the authorities and is wholly inapplicable to the facts of this case. The contention of the government that though its tax lien may be subordinate to a prior existing mortgage the lien cannot be displaced by increasing the amount of the prior incumbrance by the accrual of interest, is likewise not supported by the cited authorities and the applicable law holds to the contrary.

The argument of the government in support of its contentions embodies an attempt to segregate the mortgage interest from the mortgage debt and to consider it as a separate and distinct lien. This is contrary to the terms of the note and mortgage in question and is in effect contrary to the provisions and to the intent and purpose of the Bankruptcy Act, in as much as it is the purpose of that act to leave valid liens unaffected by proceedings in bankruptcy;—and to set a time, before payment of a secured debt, beyond which time interest would no longer be allowed, would be to affect the lien by the bankruptcy proceedings. The true rule regarding the rights of a secured

creditor of a bankrupt is that such creditor may enforce his lien against his security, where it is sufficient to cover both principal and interest, until his claim for both is satisfied, and a lien-holder may look to his lien not only for the principal but also for the interest accruing up to the date of payment, though his debtor has gone into bankruptcy.

The attorney's fee allowed below was a part of the secured debt, according to the provisions of the mortgage; and the argument hereinabove applied to the question of interest applies with equal force to the question of the attorney's fee. This allowance was consistent with the provisions of the mortgage and with the applicable law.

I.

The Questions Here Considered Are Raised for the First Time Upon This Appeal; and the Government Should Properly Be Precluded From Presenting Such Questions at This Time.

No objection was made by the government in the court below to the allowance of interest upon the mortgage debt as so allowed by that court; and upon the hearing of the application for allowance of attorney's fees no objection was made thereto. [R. 67.] And at no time during the proceedings below was objection made to such allowance.

> "It is a fundamental rule in the review of judicial proceedings that a party is not heard on appeal upon questions not raised in the trial court, 3 *C. J.* 689, sec. 580, *Edwards v. Elliott,* 21 Wall. 532, 22 L. Ed. 487; *Walker v. Sauvinet,* 92 U. S. 90, 23 L. Ed. 678; *Wilson v. McNamee,* 102 U. S. 572, 26 L. Ed. 234; *Rodrigues v. Vivoni,* 201 U. S. 371, 26 S. Ct. 475, 50 L. Ed. 792; *Huse v. U. S.,* 222 U. S. 496, 32 S. Ct.

119, 56 L. Ed. 285, and where a party has an opportunity to make an objection to a ruling adverse to him and does not do so, he cannot urge the objection on appeal. *Wood v. Wilbert,* 226 U. S. 384, 33 S. Ct. 125, 57 L. Ed. 264."

Ex Parte Keizo Kamiyama, (C. C. A. 9), 44 F. (2d) 503, at p. 505.

Also see: *Van Huffel v. Harkelrode,* 284 U. S. 225, 76 L. Ed. 256; *Diller v. Shoemaker,* (C. C. A. 9), 90 F. (2d) 98, 34 Am. B. R. (N. S.) 163; and 4 *C. J. S.* 495, Appeal and Error, sec. 244, and cases cited in note 90 thereof.

It is submitted that the contention here made by the government that interest and attorneys fees should not have been allowed as ordered below cannot be raised for the first time upon appeal. *Cook-O'Brien Const. Co. v. Crawford* (C. C. A. 9), 26 F. (2d) 574, cert. denied 49 S. Ct. 29, 278 U. S. 630, 73 L. Ed. 548; *Commercial Travelers Ass'n. v. Sanders,* (C. C. A. 1), 108 F. (2d) 643; *Smith v. Boise City, Idaho,* (C. C. A. 9), 104 F. (2d) 933 at 937; *Metropolitan Life Ins. Co. v. Armstrong,* (C. C. A. 8), 85 F. (2d) 187, at 195; *Inhabitants of City of Plainfield v. Palmer,* (C. C. A. 3), 72 F. (2d) 312; *American Surety Co. of N. Y. v. Savannah Creosoting Co.,* (C. C. A. 5), 35 F. (2d) 272; *Reliance Life Ins. Co. v. Swanson,* (C. C. A. 9), 11 F. (2d) 709. The general rule above set forth has been variously applied to questions relating to the relief granted in suits of an equitable nature, as where proper objection has not been made below regarding an award of priority to liens (See: 4 C. J. S. 640, Appeal and Error, sec. 312, note 13), or in the scope or extent to which a lien has been declared or enforced (idem., note 14). "As a general rule objections to

the mode and conduct of a hearing before or the findings or decision of a referee, master, commissioner, or auditor cannot be urged for the first time on appeal." 4 C. J. S. 636, Appeal and Error, sec. 311.

The fact that the United States Government is the appellant here furnishes no exception to the rule regarding questions raised for the first time on appeal. The general rules as to trial apply in actions in which the United States is a party, *Green v. U. S.*, 9 Wall. (U. S.) 655, 19 L. Ed. 806; and as regards appeals, the United States ordinarily stands upon the same plane as other parties. 65 C. J. 1430, United States, sec. 209.

II.

It Was Not Error to Allow Interest to the Mortgagee Subsequent to the Date of Adjudication in Bankruptcy or Sale of the Mortgaged Property, With Its Consent, and to Subordinate the Tax Liens of the United States to Such Payments.

It should be noted that the rights of appellee oil company as a secured creditor were not affected by the sale of the property in question, as the parties stipulated that the lien should be transferred to the proceeds of the sale, thereby stipulating to the transfer of all lien rights. There was no saving clause in the transfer, and the position of the secured creditor with respect to the proceeds of the sale was the same as with respect to the original security. See: *People's Homestead Ass'n. v. Bartlette,* 33 F. (2d) 561.

While conceding the composition of the oil company's lien under the terms of the mortgage in question, namely, a lien securing principal, interest and attorneys fees as

provided in the mortgage, and while conceding the superiority of that lien over the tax lien of the government, the government, however, contends for a rule that where property is subject to two liens, interest will not run on the superior to the detriment of the principal of the second, and cites *Lerner Stores Corp. v. Electric Maid Bake Shops,* 24 F. (2d) 780 (C. C. A. 5), as authority therefor, acknowledging at the same time that *Wilson v. Dewey,* 133 F. (2d) 962 (C. C. A. 8), holds a contrary view. It is submitted that the *Lerner Stores* case, *supra,* is in no sense an authority for the contended rule. While it is stated in the *Lerner* case that interest on a mortgage does not run beyond the date of the filing of a petition in bankruptcy, such statement is there based on authority of *Sexton v. Dreyfus,* 219 U. S. 339; 55 L. Ed. 244. But the rule of *Sexton v. Dreyfus, supra,* is only applicable where the security is insufficient to pay the debt with interest, and it has been so construed (see: *People's Homestead Ass'n. v. Bartlette, supra.*), and the government has conceded this limitation of the rule of *Sexton v. Dreyfus.* Aside from this point, the *Lerner Stores* case, *supra,* merely holds that if there is any surplus remaining after payment of the debt due the first lienholder, the second lienholder has a lien on that surplus and the surplus does not go into the general funds of the estate. Such holding is in effect directly contrary to the contention of the government as to the respective rights of a first and a second lienholder.

In passing, it may be well to point out what was held in *Sexton v. Dreyfus, supra.* It was there held that secured creditors of a bankrupt, selling their security after the filing of the petition in bankruptcy, and finding the pro-

ceeds of the sale insufficient to pay the whole amount of their claims, are not entitled to apply such proceeds first to interest accrued since the filing of the petition, then to the principal debt, and then prove for the balance. As pointed out in *People's Homestead Ass'n. v. Bartlette, supra, in Sexton v. Dreyfus, supra,* the secured creditors had exhausted their security, and as to the fund were unsecured creditors.

But, as conceded by the government, the rule is otherwise where the secured creditor has not exhausted his security.

> "As the obligations to pay interest is not destroyed by the insolvency and as the rights of the secured creditor in his collateral, contractual or statutory, are likewise unaffected, we are of the opinion that a secured creditor * * * may enforce his lien against his security, where it is sufficient to cover both principal and interest, until his claim for both is satisfied."

Ticonic Natl. Bank v. Sprague, 303 U. S. 406, 82 L. Ed. 926, in which case it is also stated (at pp. 930, 931, 82 L. Ed.):

> "The rule as to the date to which interest is to be allowed on secured claims sharing pro rata with unsecured claims, cannot apply to the disposition of pledged or mortgaged assets subject to the lien of individual creditors, unless we are to disregard the rights in these assets acquired prior to insolvency."

Most of the other cases cited by the government either do not sustain its contention or sustain a contrary view.

Michigan v. U. S., 317 U. S. 338, 87 L. Ed. 312, has no application to the facts of the present case, insofar as appellee oil company is concerned. That case involved a controversy over whether certain liens for state taxes has priority over the lien of the government for estate taxes. The state liens accrued subsequent to the federal tax liens, and the court held the federal liens superior. *New York v. Maclay*, 288 U. S. 290; 77 L. Ed. 754, distinguishes the situation there presented with one involving the lien of a mortgage.

In *Wilson v. Dewey*, 133 F. (2d) 962, at page 965, it is stated:

> "The rule that no interest accrues on the debts or claims of unsecured creditors after the date of bankruptcy where the bankruptcy estate is insolvent does not apply to the debts or claims of secured creditors."

See: *Coder v. Arts* (C. C. A. 8), 152 F. 943, 950; 15 L. R. A. (N. S.) 372 and *In re Faybacher*, D. C., La., 27 Am. B. R. 534, 193 F. 556. In *People's Homestead Ass'n. v. Barlette, supra*, the mortgaged property was sold free of liens at public auction in bankruptcy proceedings for more than enough to satisfy claims for principal and interest up to the date of the completed sale, and the attorney's fee. Appellant had been allowed interest up to the date of auction, but applied for interest up to the date of the completed sale. His right thereto was upheld, as well as his right to attorney fees upon the amount of interest which had been disallowed. But in that case no claim was made for interest beyond the date of the completed sale. See: *San Antonio Loan & Trust Co. v. Booth*, 2 F. (2d) 590, (C. C. A. 5), which holds a mortgagee should be allowed interest, as specified in the mortgage, so far as it

can be satisfied out of the security, up to the time of payment of the entire mortgage. The government cites *In re Stevens,* 173 F. 842, as authority for the contention that at least interest ceases on the sale of the mortgaged property free of liens. That case so holds, but on the following grounds, i.e.: that the sale is in effect the end of the proceedings, and the duty then devolves on the trustee to pay the claimant his debt and the estate ought not to be burdened with the payment of interest subsequent to that time. But the decision in that case does not consider what the situation would be in the event the trustee failed to fulfill his duty in that regard. However, *In re Stevens, supra,* is definite authority for the running of interest on a secured debt after the date of the filing of a petition in bankruptcy. The decision in that regard is based upon the ground that a lien shall not be affected by the bankruptcy act, pursuant to the provisions of section 67d thereof. The court there says (at p. 843):

> "A lien in the usual course of business is given to secure interest accruing, as well as the principal of a demand, and it needs no argument to demonstrate the fact that, if the act should declare that interest shall cease upon secured demands at a given date, whether the demands are paid or not, it would affect the lien constituting such security."

It might be pointed out that the court *In re Stevens,* in holding that interest did not run beyond the date of sale of the mortgaged property, reached a decision directly contrary to the reasoning given in the decision for the continuation of interest on a secured lien. In *San Antonio Loan & Trust Co. v. Booth, supra,* the running of interest to the time of payment of the debt was clearly upheld, on

the ground that the bankruptcy act (sec. 67d) provided that liens given or accepted in good faith should not be affected by bankruptcy, citing *Coder v. Arts, supra.* In *Phoenix Bldg. & Homestead Ass'n. v. E. A. Carrere's Sons,* 33 F. (2d) 563, the trial court allowed appellant principal and interest upon its mortgage to date of payment and such allowance was not contested upon appeal. *In re Hershberger,* 208 F. 94, holds that where the property of a bankrupt is sold free of liens, the lien attaches to the fund realized from the sale until actual payment is made, or a decree is made authorizing payment, and that interest is therefore allowed up to that time. The decision in that case quotes Judge Orr, *In re Torchia* (D. C.), 185 Fed. 584:

> "Interest is allowable on such a mortgage to the date of payment of the principal. Having been transferred from the land to the fund realized by sale, they must be payable when and only when the fund is distributable; that is, when the referee under the bankruptcy act first prepares a decree or order for distribution."

The government cites *Coder v. Arts,* 213 U. S. 223, aff'g, C. C. A. 8, 152 F. 943, as authority for the statement that when the court with the mortgagee's consent orders a sale free of liens, interest does not run beyond the day the purchaser at the sale has paid the purchase price in full. There is nothing in *Coder v. Arts, supra,* which supports this statement. The only holding in that case relative to interest on the mortgage debt was that the Circuit Court of Appeals did not err in holding that, inasmuch as the estate was ample for that purpose, Arts was entitled to interest on his mortgage debt. It should be

pointed out that the decision of the Circuit Court in *Coder v. Arts, supra,* stands for the proposition that where a trustee sells mortgaged property of the bankrupt free of the mortgage and the proceeds thereof are sufficient for that purpose, the mortgagee is entitled to the payment of the interest upon his mortgage debt as well as the principal, out of the proceeds in accordance with the terms of the note and mortgage. *In re Gotham Can Co.,* (C. C. A. 2), 48 F. (2d) 540, was a case where a secured creditor claimed service charges on the collection of accounts held as security and for attorneys fees in connection with the collections. These collections were made after adjudication of bankruptcy of the debtor to whom advances were made on the security of accounts receivable assigned to the creditor. The court allowed attorneys fees on authority of *Boise v. Talcott,* 264 F. 61; *In re Rosenblatt,* 299 F. 771. *Security Mortgage Co. v. Powers,* 278 U. S. 149, 73 L. Ed. 236; and also allowed the service charges, holding the same in the nature of interest, distinguishing the rule in *Sexton v. Dreyfus, supra.*

The government advances its theory of there being "two owners" of the property in question, i. e.: the mortgagee, to the extent of its lien, and the government, to the extent of its lien, as a fundamental reason why the mortgagee is not entitled to subordinate the government's tax liens to a greater sum than existed on the date the government's liens attached. For this proposition *United States v. City of Greenville,* 118 F. (2d) 963 (C. C. A. 4), is cited as authority. In that case the reference to property having in a sense two owners was made in connection with a discussion of two types of transactions where real estate taxes are not considered "taxes" within the meaning of

26 U. S. C. A., Int. Rev. Code, sec. 23(c). One such transaction is one involving the purchase of property to which a tax lien has attached. The court stated that "that property has in a sense two owners, the seller, and through the lien, the state. Hence, its full acquisition entails two payments, the nominal purchase price, and the taxes represented by the lien". *U. S. v. City of Greenville, supra,* involves a question as to when taxes may be deducted from gross income under the provisions of the Internal Revenue Code. Consideration of whether a property has in a sense "two owners" in determining whether a payment of taxes on a sale of real property may be deducted as a "payment of taxes," under the Internal Revenue Code, or is to be considered a capital expenditure has no application to the consideration of the relationship of the respective liens of a mortgagee of real property and of the Federal government for taxes. The contention of the government based on the ground of there being "two owners" of the property is wholly without foundation.

It is recognized that the language used in the provisions of Section 67, sub. a(1) of the Bankruptcy Act of 1938, 11 U. S. C. A. sec. 107, sub. a(1) clearly implies that every lien so obtained more than four months before the filing of a petition in bankruptcy shall be valid as against the trustee in bankruptcy. See: *Kaufman v. Eastern Baking Co.,* 53 F. Supp. 364, at 367. A valid lien, therefore, is not destroyed by insolvency and remains unaffected by the provisions of the Bankruptcy Act. *Ticonic Nat'l. Bank v. Sprague, supra; San Antonio Loan & Trust Co. v. Booth, supra;* and to stop the running of interest upon a secured debt, where the security is sufficient to pay the debt with interest, would be to affect the lien adversely by

the proceedings in bankruptcy, contrary to the intent and purpose of the Bankruptcy Act.

The government contends that "accrual of interest on the mortgage debt is not within the classes enumerated and protected by the statute" (R. S. sec. 3186, as amended, 26 U. S. C. A., secs. 1560, 1561, 1562). Such classes are (1) mortgagee, (2) purchaser, (3) judgment creditor. The government cites *MacKenzie v. U. S.,* 109 F. (2d) 540, as authority. That was a case in which a creditor who had attached a taxpayer's property contended that he was entitled to be considered a "judgment creditor" within the meaning of the statute. The court held that there was no authority for such a contention. But a mortgagee is expressly entitled to the protection of the provisions of the statute in question, and the interest on the amount due is a part of the mortgage debt, and the unrecorded tax lien is by the statute provided to be not valid as against a mortgagee. The case cited is in no way applicable to the present situation. An attachment is in no sense analogous to the lien of a mortgage for interest due thereunder in view of the express provisions of the statute.

The principal and interest under the obligation secured by the mortgage in question are all part of the mortgage debt secured by the lien thereunder. There need be no doctrine of "relation back" to bring after accrued interest under the lien of the mortgage. In this connection, see *Security Mortgage Co. v. Powers,* 278 U. S. 149, 73 L. Ed. 236. The amounts secured by the lien of the mortgage may not be segregated. If the lien of the mortgage is prior to that of the government for taxes, and the security is sufficient to pay the amount due, the mortgagee is entitled to satisfaction of the debt due him prior to payment

of the amount due the government for taxes. The whole is equal to the sum of its parts, and the mortgage lien, and all sums thereby secured must be treated as an entirety.

It should be pointed out that the government makes no contention that the security, namely, the proceeds from the sale of the property, is insufficient to pay the mortgage debt.

The total estate was $21,243.30. The oil refinery plant was sold for $19,927.85, of which $273.00 was personalty. In other words, the mortgage covered $19,654.83. [Transcript of the Record page 64.] The expense of administration, including payment of various current taxes, etc., amounted to $6929.83. [Transcript of the Record page 74.] It is obvious from these figures and the record that there was and is more than sufficient property subject to the lien of Universal Consolidated Oil Company's mortgage, to pay the balance of principal due Universal Consolidated Oil Company, the interest thereon and the attorney's fees, i.e., $11,234.78, as of January 15th, 1944.

The Government did not raise the question of interest at the time of the transfer of the lien, it alone raised the question of what was personalty and what was real property covered by the mortgage, thus causing several days of hearing before the Referee, i.e., it attacked the mortgage. It alone attacked the findings of the Referee. It alone objected to the order of the Circuit Court upholding the Referee. The necessary conclusion is that it alone has caused the delay, so far as Universal Consolidated Oil Company's payment is concerned, and so any interest which has accrued, or is accruing as the result of the position of the Government, should equitably be borne by it.

It may well again be emphasized in this summary that the transfer of the lien was the subject of stipulation without reservation as to interest or Attorney's fees. There was no objection on the part of the Government to the granting of Universal Consolidated Oil Company's petition for attorney's fees, and the points concerning interest and attorney's fees were not raised by the Government until after the decision of the District Court.

III.

The Tax Liens of the United States Were Not Entitled to Be Satisfied Ahead of the Attorney's Fees Awarded to the Mortgagee.

Security Mortgage Co. v. Powers, supra, is conclusive authority for the proposition that the attorney's fees were part of the debt secured by the mortgage and are collectible as such. In that case property of a bankrupt was subject to the lien of a mortgage debt. The trustee applied for leave to sell the property free of the lien. Leave to sell was granted, preserving to the lien creditor its right in the proceeds of the sale. The secured indebtedness was represented by a principal note and ten coupons, providing for payment with interest with all costs of collection, including attorneys fees (to the extent of 10%). So far as appears the lien holder did not employ an attorney until after it had been served with an order to show cause on the trustee's application for leave to sell the property. There had been no default before adjudication. The court held the attorney's fees part of the mortgage debt notwith-

standing that they accrued after adjudication. The court states:

> "The contingent obligation to pay attorney's fees was a part of the original transaction."

The Government here makes no contention that attorney's fees as provided in the note and mortgage were not made a part of the debt, or would not be secured by the same lien. The only argument the Government advances against the allowance of the fees in question is that once the Government's lien attached, it was subordinated only to the amount then due on the mortgage and this sum could not be opened up and increased by attorney's fees for services to be performed in the future by any doctrine of "relation back." As already pointed out under Point II hereof, there is no need to employ any doctrine of "relation back" to support the lien for attorney's fees; and what has already been said under Point II regarding the allowance of interest is also true of the question of the allowance of attorney's fees. The cases heretofore cited in support of the mortgagee's right to interest are equal authority in support of its right to the fees in question, and are referred to herein in that connection. See in particular: *People's Homestead Ass'n. v. Bartlette supra, In re Gotham Can Co., supra,* While it is true that liability for a fee depends upon the rendition of legal services, where such services have necessarily been rendered, (and here the rendition was compelled by the Government i.e., the party objecting after causing the services), there is no question that the fee is properly allowed, provision having been made therefor under the obligation.

Conclusion.

For the reasons stated the order of the District Court affirming the order of the Referee is correct (so far as Universal Consolidated Oil Company is concerned) and should be affirmed. The United States Circuit Court of Appeal, for the Ninth Circuit, is hereby respectfully requested to make its order accordingly.

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